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No. 07-512

IN THE
Supreme Court of the United States

PACIFIC BELL TELEPHONE COMPANY
d/b/a AT&T CALIFORNIA, *et al.*,

Petitioners,

v.

LINKLINE COMMUNICATIONS, INC., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF *AMICI CURIAE* PROFESSORS AND SCHOLARS IN LAW AND ECONOMICS IN SUPPORT OF THE PETITIONERS

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QUESTION PRESENTED

Whether a plaintiff states a claim under section 2 of the Sherman Act by alleging that the defendant—a vertically integrated retail competitor with an alleged monopoly at the wholesale level but no antitrust duty to provide the wholesale input to competitors—engaged in a "price squeeze" by leaving insufficient margin between wholesale and retail prices to allow the plaintiff to compete.

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INTERESTS OF THE *AMICI CURIAE*[1]

Amici are professors and scholars in law and economics who have taught, or have conducted research

1. No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than Amici Curiae, or their counsel, made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief and such consents are being lodged herewith.

on, antitrust law and the economics of industrial organization. They include William J. Baumol, Robert H. Bork, Robert W. Crandall, George Daly, Harold Demsetz, Jeffrey A. Eisenach, Kenneth G. Elzinga, Richard A. Epstein, Gerald Faulhaber, Franklin M. Fisher, Charles J. Goetz, Robert Hahn, Jerry A. Hausman, Keith N. Hylton, Thomas M. Jorde, Robert E. Litan, Paul W. MacAvoy, Sam Peltzman, J. Gregory Sidak, Pablo T. Spiller, and Daniel F. Spulber. A summary of names and affiliations appears in the Appendix at the end of this brief. *Amici* file solely as individuals and not on behalf of any institutions with which they are affiliated.

INTRODUCTION

As professors and scholars in law and economics who teach and conduct academic research on antitrust law, we agree with the petitioners that the Ninth Circuit has generated an inescapable conflict among circuits, and that the Ninth Circuit's opinion below is incompatible with this Court's reasoning in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007), and *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). We agree with Judge Gould's dissent in *linkLine* that *Trinko* "takes the issues of wholesale pricing out of the case," such that the plaintiffs' only possible remaining theory of harm would be predatory pricing at the retail level—which the plaintiffs did not allege. *linkLine Commc'ns Inc. v. Pac. Bell Tel. Co. d/b/a/ AT&T Cal., Inc.*, 503 F.3d 867, 886

(9th Cir. Sept. 11, 2007) (Gould, J., dissenting). We also agree with Judge Ginsburg's opinion for the D.C. Circuit in *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666 (D.C. Cir. 2005), which in turn embraces the conclusion of the Areeda-Hovenkamp treatise that "'it makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal.'" *Id.* at 673-74 (quoting 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 767c3, at 129-30 (2d ed. 2002)). The existence of a rule like *linkLine* has a pervasive impact on business behavior that, at the margin, affects competition and consumers. This deleterious effect extends beyond the telecommunications industry to affect all firms that do business in the Ninth Circuit.

SUMMARY

In our minds, an even larger issue is at stake in this case. The Ninth Circuit's decision in *linkLine* implicates the normative foundation of modern Sherman Act jurisprudence: that antitrust law exists to advance consumer welfare. We have three points to make.

First, any rule of price-squeeze liability that threatens liability based on the claim that the difference between a firm's upstream and downstream prices leaves downstream rivals insufficient margin substitutes a rule of competitor welfare for consumer welfare.

Second, properly understood, a price squeeze is a regulatory issue, which makes sense only as a rule of price regulation in an industry already subject to duties to deal and to control by institutionally competent

regulators. Attempting to implement regulatory policy through section 2 of the Sherman Act is ill-advised, both because it makes no sense for courts to re-regulate deregulated or lightly regulated industries, and because courts lack the institutional competence to implement regulation.

Third, the Ninth Circuit's rule is of pressing concern precisely because it will deter efficiency-enhancing conduct and competitive pricing. Vertical integration and partial integration are ubiquitous, and firms need to be able to make decisions about such integration without the threat of liability. Vertically integrated firms likewise need to be free to cut retail prices (as long as the prices are not predatory) without concern for rivals—the point of *Brooke Group*. Moreover, the Ninth Circuit's standard is so vague and open-ended that it creates uncertainty and invites litigation; it also permits imposition of liability based on apparently subjective evaluation of disputed and hard-to-prove facts, which will lead to a substantial risk of false positives.

ARGUMENT

It is not possible to advance consumer welfare with an antitrust rule that punishes a firm for failing to ensure its competitors' profitability. If *linkLine* stands, the lower federal courts will have put antitrust at war with itself to a degree not witnessed since the years before the Court's conscious decision, three decades or more ago, to infuse antitrust law with greater economic rigor so that it might better advance consumer welfare.

The alternative to consumer-welfare maximization is the view that antitrust law is simply one more tool of industrial policy, and thus its application may permissibly compromise consumer welfare to advance the welfare of competitors. Other nations evidently consider this normative proposition to be appropriate, if recent developments in the European Union are a valid indication. More than ever before, the United States and Europe appear to be at a fork in the road over whether the law of monopolization exists to protect consumers or to ensure that a specified number of firms will profitably populate a market. The Ninth Circuit's *linkLine* decision implicitly chooses the latter path, which leads to the Potemkin village of "managed competition." *See* Robert W. Crandall & Hal J. Singer, *Life Support for Unaffiliated ISPs?*, REGULATION, Fall 2005, at 46. *See also* Dennis W. Carlton, *Should "Price Squeeze" Be a Recognized Form of Anticompetitive Conduct?*, 4 J. COMPETITION L. & ECON. 271 (2008); J. Gregory Sidak, *Abolishing the Price Squeeze as a Theory of Antitrust Liability*, 4 J. COMPETITION L. & ECON. 279 (2008).

To say that American antitrust law does not—and should not—recognize a cause of action for price squeeze by a firm that owes no duty to deal with rivals is not to say that one cannot find the concept of a price squeeze embraced somewhere else in American law. One can. In public utility regulation, the price-squeeze issue arises in proceedings concerning "access pricing" and "imputation."[2] Extensive economic literature exists on

2. *See*, *e.g.*, WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY (MIT Press 1994); William J. (Cont'd)

how regulators would maximize consumer welfare in the pricing of bottleneck inputs that a vertically integrated monopolist sells to its competitors in a downstream market. But three points about price-squeeze regulation bear emphasis.

First, these cases are highly technical *regulatory* proceedings that are typically protracted and factually intensive. *See Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, J.) (a price-squeeze case requires a court to "act[] like a rate-setting regulatory agency, the rate-setting proceedings of which often last for several years"). Price-squeeze cases are precisely the kinds of proceedings that would be unwieldy to attempt to replicate through antitrust litigation. Imputation analysis requires the estimation of incremental cost. Economic estimation of that nature demands a kind of quantitative expertise that a judge or jury is not likely to possess. Even so ambitious and invasive a monopolization case as the Bell System divestiture, *United States v. AT&T Corp.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983), did not attempt to use antitrust law as a tool for regulating the price of wholesale services supplied by monopoly local exchange carriers.

(Cont'd)

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Second, these regulatory proceedings arise because the vertically integrated firm has a preexisting regulatory duty to deal with competitors in a downstream market. This feature is the element of compulsion that was so critical to the Court's reasoning in *Trinko*. *See Trinko*, 540 U.S. at 412-16.

Third, the experience with price-squeeze cases brought by national competition authorities in Europe under Article 82 of the Treaty of Rome reveals the economic and factual complexity of correctly implementing the imputation analysis in an antitrust case. It becomes necessary to hypothesize what an efficient competitor would be and then determine whether the defendant's wholesale and retail prices permit the efficient competitor to earn some level of profit deemed to be sufficient.[3] This kind of analysis, however, merely underscores (1) that the primary concern in price-squeeze cases is not consumers, but competitors, and (2) that, in the American setting, the requisite analysis more resembles the work of a public utilities commission than that of a federal judge presiding over an antitrust case. By definition, the judge's job as de facto rate regulator never ends because external forces will compel wholesale and retail prices to change over time, such that a given profit margin

3. *See*, *e.g.*, Michele Polo, *Price Squeeze: Lessons from the* Telecom Italia *Case*, 3 J. Competition L. & Econ. 453 (2007); Laura Ferrari Bravo & Paolo Siciliani, *Exclusionary Pricing and Consumer Harm: The European Commission's Practice in the DSL Market*, 3 J. Competition L. & Econ. 243 (2007); Damien Geradin & Robert O'Donoghue, *The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector*, 1 J. Competition L. & Econ. 355 (2005).

may shrink and jeopardize the survival of competitors. The perverse outcome is that price-squeeze litigation becomes a kind of enduring cost-of-service regulation that taxes the resources of a single district judge.

The Telecommunications Act of 1996 provides an instructive analogy that provoked multiple opinions in *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999). There, the statute (applied in a regulatory proceeding) entitled a competitor to access any one or more of an incumbent local exchange carrier's unbundled network elements at a regulated price if that competitor would be "impaired" in its ability to supply a (downstream) telecommunications service in the event that the competitor were denied access to a particular network element (at the regulated price). Congress did not attempt to provide a precise economic definition of "impairment." It is a measure of the complexity of administering that concept that Justices Scalia, Breyer, and Souter debated how much of a cost disadvantage would be enough to trigger the "impairment" standard. *Iowa Util. Bd.*, 525 U.S. at 392, 399-400, 416-18. That question admitted no easy answer—and it got none in multiple remands to the Federal Communications Commission over the course of many years. Yet the determination of "impairment" under the Telecommunications Act fundamentally resembles the line of economic analysis that a court would need to undertake in a price-squeeze case based on the Sherman Act.

Shortly after *Iowa Utilities Board*, some scholars on telecommunications regulation argued that the "impairment" exercise should be regarded as

unproductive unless it could be shown that finding "impairment" and granting a competitor access to the incumbent's bottleneck element at a regulated price would increase consumer welfare in the downstream market. *See* Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to Mandatory Unbundling of Telecommunications Networks*, 109 YALE L.J. 417 (1999). In other words, if there is no causal connection between assisting competitors and improving consumer welfare, then the regulatory intervention is strictly a wealth transfer. The same criticism applies to an antitrust cause of action for price squeeze. The theory of price squeeze is dissonant with consumer welfare maximization for the simple but perverse reason that, as conceived by the Ninth Circuit, harm to consumer welfare is irrelevant to the imposition of antitrust liability.

A word about *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416 (2d Cir. 1945), is necessary because the Ninth Circuit is incorrect to the extent that it reads *Alcoa* to have imposed section 2 liability under a price-squeeze theory for an attempt to monopolize the downstream (aluminum sheet) market. It is too abbreviated for the Ninth Circuit to characterize *Alcoa* as "holding [Alcoa's] price squeeze unlawful," *linkLine*, 503 F.3d at 880, and then to assert that "a price squeeze theory formed part of the fabric of traditional antitrust law prior to *Trinko*. . . ." *Id.* at 883.

In *linkLine*, the plaintiffs argued that the telephone company used its retail pricing of broadband Internet access (aluminum sheet) and its pricing of DSL transport (aluminum ingot) to monopolize broadband

Internet access (aluminum sheet). In *Alcoa*, however, the Second Circuit said that the price squeeze, which it found to deny downstream competitors a "living profit" in violation of section 2 of the Sherman Act, "was not part of an attempt to monopolize the 'sheet' market." *Alcoa*, 148 F.2d at 438. Because the analogy to sheet aluminum in *linkLine* is broadband Internet access (not DSL transport), *Alcoa* does not support the position of either the plaintiffs or the Ninth Circuit that the alleged price squeeze potentially violates section 2 *with respect to the market for broadband Internet access.*

Moreover, *Alcoa*'s concern over preserving a "living profit" for Alcoa's competitors could not be farther removed from the contemporary consumer-welfare orientation of antitrust law. The Court in *Trinko* considered *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), to be on the ragged edge of viability as a theory of antitrust liability. The "living profit" reasoning of *Alcoa* should be sufficient to confirm that, sometime during the intervening 62 years, the Court's evolving jurisprudence based on consumer-welfare maximization implicitly overruled the competitor-welfare premise of *Alcoa*'s price-squeeze analysis.[4] For example, in *Trinko* this Court said that courts should not act as "central planners." *Trinko*, 540 U.S. at 408. However, to determine a "fair price" and a

4. Compare, for example, how the D.C. Circuit in *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 226 (D.C. Cir. 1986) (Bork, J.), reasoned that, by 1986, certain Supreme Court decisions had been implicitly overruled by the analysis contained in the Court's more recent cases embracing the consumer-welfare approach.

"living profit," two of three elements of a prima facie price-squeeze claim under the *Alcoa* analysis, a court must do just that. Forcing a firm to share its resources with downstream competitors, and dictating "fair prices" for these resources, strains the resources of the judiciary, as this Court has noted.

In *Alcoa*, the Second Circuit asserted that the purpose of the Sherman Act is to "preserve, for its own sake and *in spite of possible cost*, an organization of industry in small units." *Alcoa*, 148 F.2d at 429 (emphasis added). All of the legal analysis in *Alcoa* that builds from this premise is suspect in light of the fact that, at least three decades ago, this Court emphatically expressed a different normative objective for antitrust law. Today, *Alcoa*'s view of the normative purpose of antitrust law more closely resembles Europe's perspective than America's. In *NCAA v. Board of Regents of the University of Oklahoma*, 468 U.S. 85 (1984), *Trinko*, and many other cases, this Court has endorsed the view that the Sherman Act's concern is consumer welfare, not competitor welfare. Compelling an income transfer from a vertically integrated firm to its downstream competitors does not advance the Sherman Act's consumer-welfare goal.

In light of this weak foundation for the price-squeeze theory of liability, we find it startling that the Ninth Circuit never discussed the First Circuit's decision in *Town of Concord*, written in 1990 by then-Judge Breyer. *Town of Concord* is the single most informative opinion in American antitrust jurisprudence for understanding the law and economics relevant to evaluating a price-squeeze claim. It is no surprise that this Court's decision

in *Trinko* quotes liberally from *Town of Concord* and confirms the correctness of its reasoning that the antitrust laws are concerned with the competitive *process*, not its end results. The Ninth Circuit relied on decisions from the Second, Third, Seventh, and Eighth Circuits—but its survey of the pertinent law on price squeezes did not reach Judge Breyer's extended analysis in *Town of Concord*.

In *Town of Concord*, the First Circuit rejected a price-squeeze claim for reasons that implicate the validity of *Alcoa*. First, the court noted that a price squeeze can have procompetitive effects: "the primary-level monopolist might carry out its second-level activities more efficiently than its independent competitors," thereby eliminating less efficient second-level competitors from the market, which results in lower prices and saves economic resources. 915 F.2d at 24. Moreover, if a second-level firm is itself a monopolist, it is desirable to allow the upstream monopolist to squeeze out the downstream monopolist, because the downstream monopolist, in its effort to extract its own monopoly rents, can increase the price of the end-product beyond the price that results from just one firm's extraction of monopoly rent (either realized at the wholesale or retail level). *Id.* at 24-25. For this reason, antitrust scholars applaud the elimination of this phenomenon of "double marginalization." *See*, *e.g.*, 3A Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 758b at 30 (2d ed. 2002).

Second, foreshadowing the Supreme Court's concerns in *Trinko*, Judge Breyer highlighted the adverse administrative considerations that counsel

against recognizing price-squeeze claims. These administrative considerations implicate *Alcoa*'s core elements: a "fair price" for the wholesale product and a "living profit" for second-level competitors. Questioning the practicality of administering remedies for an unlawful price squeeze, Judge Breyer asked rhetorically how a judge or jury could determine a fair price or a proper price gap between the wholesale and retail prices. *Town of Concord*, 915 F.2d at 25. What *Trinko* recognized as a fatal flaw in a refusal-to-deal theory—namely, that "[e]nforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill suited," *Trinko*, 540 U.S. at 408—is, as *Town of Concord* indicates, just as fatal for an *Alcoa* price-squeeze claim. As explained by the current chief economist of the Antitrust Division of the Department of Justice, to determine a "fair price" or a "living profit" for firms that meet some threshold level of efficiency, courts must "become a type of regulatory body setting complex terms . . . in an area where, unlike a regulatory body, the courts have no special expertise." Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why* Aspen Skiing *and* Kodak *Are Misguided*, 68 ANTITRUST L.J. 659, 662 (2001).

CONCLUSION

In sum, it is imperative that the Court clarify that the price-squeeze theory is a regulatory undertaking, not an antitrust cause of action. It is neither feasible nor advisable to use antitrust law to make a vertically integrated firm responsible for ensuring the profitability of its competitors in the downstream market. Such a rule would create a powerful incentive for the vertically integrated firm to raise its retail price to reduce the risk of antitrust lawsuits by unprofitable downstream competitors. That result is antithetical to the consumer-welfare objective that animates American antitrust law.

Respectfully submitted,

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